

## PLDT-Sun acquisition: good or bad?

*Rafaelita M. Aldaba*

For more than half a century, the country's telecommunications sector was dominated by a private monopoly, the Philippine Long Distance Company (PLDT). During this entire period, the Philippines' telecommunications sector was in a dismal state as indicated by the long waiting time to own a telephone which at worst took more than 10 years. Due to underinvestment in the sector, a huge telephone backlog existed, telephone service was generally unavailable, and where it was, the quality of service was unreliable.

### A history of dominance

All these changed with the opening up of the telecommunications sector in the late 1980s up to the early 1990s. The entry of new players led to rapid growth in the industry as foreign investment increased and new services emerged. However, despite the entry of new players, PLDT continued to dominate the industry due to its ownership of the backbone network and to its largest share in the total number of fixed lines. Being the owner of the domestic backbone

system, PLDT was able to influence not only the speed but also the terms and conditions for interconnection as well as terms and conditions for revenue-sharing arrangements.

As this developed, First Pacific bought control of PLDT and consolidated its position in the Philippine telecommunications industry by synthesizing the operations of PLDT and First Pacific's Smart, the leader in the cellular phone market. During that time, Smart and Piltel (PLDT subsidiary) had a combined share of 68 percent of the total number of cellular telephone subscribers while PLDT and Smart together accounted for 43 percent of the total number of installed lines. The merger of the dominant firms in the fixed and mobile markets reinforced PLDT's position with its combined telephone and cellular phone subscribers of 3.87 million accounting for 48 percent of the total number of telephone and

*PIDS Policy Notes* are observations/analyses written by PIDS researchers on certain policy issues. The treatise is holistic in approach and aims to provide useful inputs for decisionmaking.

The author is Senior Research Fellow at the Institute. The views expressed are those of the author and do not necessarily reflect those of PIDS or any of the study's sponsors.

cellular phone subscribers. With this strategic move, PLDT has retained its market power.

After the consolidation, two companies, PLDT-Smart, along with Globe, emerged as the formidable telecommunications companies in the country. Competition was muted as the two telecommunications giants offered basically the same prices for their services. For instance, text messages cost P1 each. In 2003, Sun Cellular of Digitel entered the market and started offering 24/7 unlimited call and text messaging. The top two incumbent companies immediately charged Sun Cellular of predatory pricing and filed separate petitions before the National Telecommunications Commission (NTC) to stop Sun Cellular's service and fix call rates at P5.50 per minute and bar Sun from charging much lower rates. After the NTC ruling in favor of Sun, Smart and Globe also offered fixed rate or "bucket" plans for voice and text services. Smart and Globe were forced to apply restrictions after experiencing network congestions during peak times and even resorted to suspending their promotions during holiday seasons.

### **Intensifying competition with third party entry**

Overall, after the entry of Sun Cellular, competition in cellular mobile service has become intense. The telecommunications companies (telcos) have continued to fight for market shares largely focused on unlimited plans and aggressive bucket offers such as Globe's Super All Txt 20 which, for P20 a day allows a subscriber to send 200 text messages to any network (P0.10/SMS). Globe's Unli Txt All Day allows one to send unlimited text messages to Globe/TM subscribers for one day. Smart Buddy's

AllTxt Combo Plus at P25 gives a subscriber 100 text messages to another Smart subscriber, 10 texts to other networks, plus five minutes of calling. Sun Cellular's P25 Superloaded Call and Text Unlimited has free 30 minutes of mobile internet on top of unlimited Sun-to-Sun calls and 10 texts to other networks. Its Sun TextALL at P15 a day enables a subscriber to send 150 text messages to any network.

While traditional revenue sources like international and national long distance (IDD and NDD) calls are already on a decline, demand has been strong for new revenue sources such as broadband Internet services whose prices have also been declining due to unlimited plans and bucket offerings. For P50 a day, a Globe subscriber is given unlimited access to the Internet using a Globe Tattoo Broadband USB or mobile phone for one day. Smart also offers unlimited mobile surfing for P50 per day while Smart Broadband has its unlimited Internet access promo at P200 for five days. Sun Broadband prepaid has a similar offering (one day unlimited for P50).

With intense competition, the telcos' margins have come under pressure even as demand for more network services increased. PLDT Chairman Manuel Pangilinan pointed out that while daily outbound text messages increased from 800–900 million to 1.2 billion, yields declined from 18 centavos to 13 centavos/text. In 2010, revenues from cellular data/text dropped by 13 percent to P31 billion despite a 25 percent increase in text volume.<sup>1</sup> Globe's postpaid average revenue per

<sup>1</sup> M. Reyes, "A year of changing dynamics," *Philippine Star*, (30 December 2010).

unit (ARPU) fell to P1,168 while Smart's postpaid ARPU remained steady at P1,257 (Business Monitor Quarter 3 2010).

With mobile telephony now already considered a mature industry (cellular penetration exceeding 80%), broadband Internet services are expected to be the sector's new growth driver. According to Business Monitor International, Smart and Globe continued to report strong growth in their broadband business segment. Total broadband subscribers for the two operators crossed the 2 and 1 million mark, respectively, and wireless broadband take-up is the main subscriber growth driver for Smart and Globe.

### **Redux: reconcentration of market power – will it benefit the public welfare?**

It is amid this setting of falling revenues in cellular services (an industry segment nearing maturity) but with high prospects for broadband Internet services (another segment which is still in its infancy and expected to compensate for the decline in cellular revenues) that PLDT has recently acquired Digitel. The deal would result in a duopoly with PLDT's Smart, Talk N'Text (Piltel), Red Mobile (CURE), and Sun (Digitel), on the one hand, and Globe Telecom and Touch Mobile (TM) on the other. PLDT now controls 70 percent of the total cellular subscribers while Globe controls the remaining 30 percent (Table 1). Digitel has 400,000 broadband subscribers to be added to PLDT's 2 million subscribers.

How will this reconcentration in the industry affect overall welfare? It is important to distinguish between welfare-enhancing mergers and acquisitions (M&As) and welfare-

**Table 1. Number of subscribers and percentage shares: 2009 and 2010**

| Telco           | Number of Cellular Subscribers |      | % Share prior to Acquisition |      | % Share after Acquisition 2010 |
|-----------------|--------------------------------|------|------------------------------|------|--------------------------------|
|                 | 2010                           | 2009 | 2010                         | 2009 |                                |
| - Globe         | 14.4                           | 13.8 |                              |      |                                |
| - Touch Mobile  | 11.8                           | 9.3  |                              |      |                                |
| Globe, subtotal | 26.2                           | 23.1 | 29.8                         | 31.1 | 29.8                           |
| Sun             | 16                             | 10   | 18.2                         | 13.5 |                                |
| - Smart         | 25.7                           | 24.2 |                              |      |                                |
| - Talk 'N Text  | 19                             | 17   |                              |      |                                |
| - Red Mobile    | 0.95                           |      |                              |      |                                |
| Smart, subtotal | 45.65                          | 41.2 | 52.0                         | 55.5 | 70.2                           |
| Industry Total  | 87.85                          | 74.3 |                              |      |                                |

diminishing M&As. In the former, M&As between firms can be an effective way of developing competitive advantage, optimizing the benefits of complementary strengths, and taking advantage of economies of scale and scope. M&As can also work as an important discipline upon poorly performing management. All these could lower the operating costs, for instance, of PLDT. Thus, the M&A activity can improve efficiency to the benefit of consumers and the country in general. Existing Sun subscribers can benefit from PLDT's wider network coverage. Smart can also expand its network capacity if it is able to use Sun's 3G frequency which could lead to less network congestion and improved wireless connectivity. Note that radio spectrum is an essential input for wireless telecommunications such as mobile telephony or wireless internet access. Access to this essential resource is restricted to those owning a license.<sup>2</sup> Three of

<sup>2</sup> Licenses for using radio spectrum are applied due to a negative externality: too many firms broadcasting on the same frequency range may cause mutual interference degrading signal quality.

the four 3G<sup>3</sup> licenses awarded by NTC are now owned by PLDT (Smart, Sun, and Connectivity Unlimited Resource Enterprise, Inc. [CURE], a new player which was eventually bought by Smart in 2008).

On the other hand, however, M&As can result in a decline in the number of players in an industry, at least in the short run. In some cases, particularly where there are significant barriers to entry, M&As can lead to increased industry concentration and increased market power which may run counter to national welfare. It is not easy to enter the industry due to existing barriers such as a separate franchise requirement for each telecommunications sector as well as constitutional restrictions limiting foreign participation to 40 percent. Obtaining a congressional franchise is difficult and costly, apart from the need to have political influence. Moreover, access to radio spectrum is another constraint for new entrants, especially if this is concentrated in the hands of only one player. Until these entry barriers are addressed, competition will be limited and the industry would continue to reap oligopoly rents.

<sup>3</sup> 3G technology provide high-speed data transmission and support multimedia applications such as full-motion video, video conferencing, and Internet access, alongside conventional voice services.

*For further information, please contact*

The Research Information Staff  
Philippine Institute for Development Studies  
NEDA sa Makati Building, 106 Amorsolo Street, Legaspi Village, 1229 Makati City  
Telephone Nos: (63-2) 894-2584 and 893-5705  
Fax Nos: (63-2) 893-9589 and 816-1091  
E-mail: raldaba@mail.pids.gov.ph; jliguton@mail.pids.gov.ph

The *Policy Notes* series is available online at <http://www.pids.gov.ph>. Reentered as second class mail at the Business Mail Service Office under Permit No. PS-570-04 NCR. Valid until December 31, 2011.

### Recommendations to ensure competition and welfare improvement

To ensure that mergers and acquisitions do not create or enhance market power which can damage emerging competition, it is necessary to remove barriers to entry and have laws and policies that would ensure market contestability and regulate anticompetitive business conduct or practices. For instance, in the US, Japan, Korea, and Singapore, mergers and acquisitions are controlled when they tend to stifle competition substantially or to create a monopoly. Substantive assessment of mergers is conducted using important criteria such as market structure and efficiency arising from the merger or acquisition. The industry regulator NTC said it would review the acquisition.

If effective competition has to emerge, the government must pursue regulatory reforms toward the creation of competitive market and industry structures. Regulatory barriers include the need for Congressional franchise, foreign equity limitations, and access to radio spectrum. Given these high entry barriers along with the absence of effective competition law, the recent acquisition of Sun might pose some risks for competition. Past experience shows how PLDT behaved in the face of increased competition from new entrants. Without effective competition laws acting as safeguards for fair competition, it may be difficult to control mergers and acquisitions, particularly those that lead to substantial increases in industry concentration. Along with the difficulties posed by the high barriers to entry, the PLDT-Sun deal may endanger both competition in the industry and any welfare improvement arising from the deal. 📄